



## **CRS Report for Congress**

# **The Future Role of U.S. Trade Policy: An Overview**

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### **Summary**

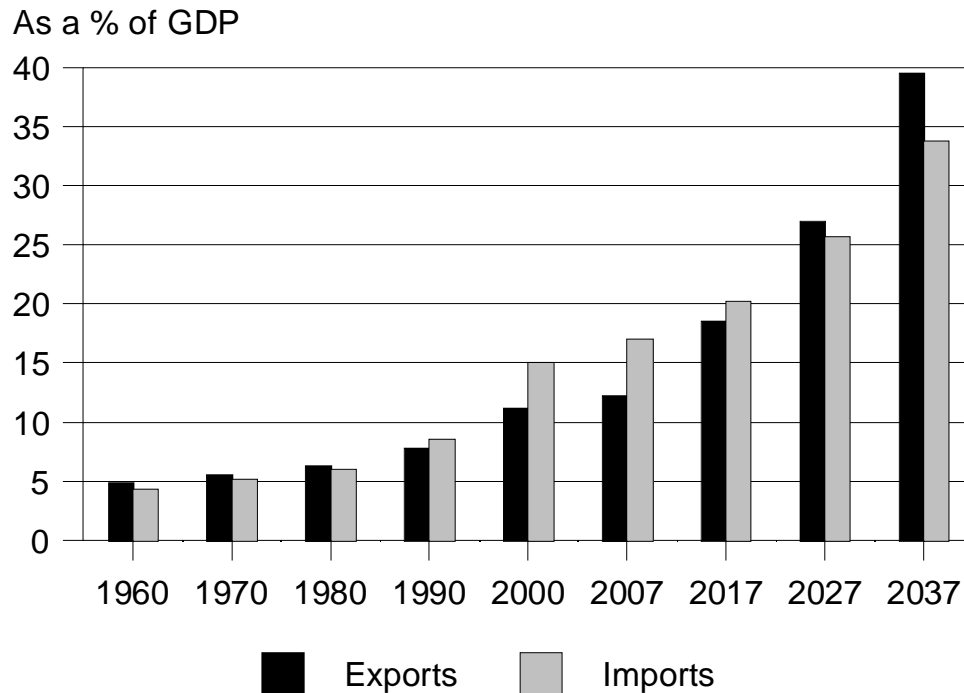
The United States has become increasingly integrated with the rest of the world economy. This integration has offered benefits and presented challenges to U.S. business, agriculture, labor, and consumers. Those who can compete in the more integrated economy have enjoyed opportunities to broaden their success, while those who are challenged by increased foreign competition have been forced to adjust and some have exited the market or relocated overseas. Some observers contend that, in order to remain globally competitive, the United States must continue to support trade liberalization policies, while assisting those hurt by trade. Others have raised doubts over whether free trade policies benefit the U.S. economy (e.g., some blame such policies for the large U.S. trade deficit, declining wages, and growing income disparity). Many contend that trade liberalization works only when everyone plays by the rules and have urged the aggressive enforcement of U.S. trade laws to address unfair trade practices. Still others maintain that such issues as labor rights, the environment, and climate change should be linked to trade policies. These competing views are often reflected in the struggle between Congress and the Executive branch in shaping U.S. trade policy. This report provides an overview and background on the debate over the future course of U.S. trade policy and will be updated as events warrant.

### **U.S. Integration With the World Economy**

Over the past several years, the United States has become increasingly integrated with the world economy. In 2007, the United States was the world's largest exporter (at \$1.6 trillion) and largest importer of goods and services (at \$2.4 trillion). From 1960 to 2007, U.S. exports of goods and services as a share of gross domestic product (GDP) rose from 4.9% to 12.2%, while imports rose from 4.3% to 17.0%. The Economist Intelligence Unit (EIU) projects that by the year 2037, U.S. exports and imports as a percent of GDP will total 39.5% and 33.8%, respectively (see figure 1).

Report Documentation Page				Form Approved OMB No. 0704-0188	
Public reporting burden for the collection of information is estimated to average 1 hour per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to Washington Headquarters Services, Directorate for Information Operations and Reports, 1215 Jefferson Davis Highway, Suite 1204, Arlington VA 22202-4302. Respondents should be aware that notwithstanding any other provision of law, no person shall be subject to a penalty for failing to comply with a collection of information if it does not display a currently valid OMB control number.					
1. REPORT DATE <b>14 JUL 2008</b>		2. REPORT TYPE		3. DATES COVERED <b>00-00-2008 to 00-00-2008</b>	
4. TITLE AND SUBTITLE <b>The Future Role of U.S. Trade Policy: An Overview</b>				5a. CONTRACT NUMBER	
				5b. GRANT NUMBER	
				5c. PROGRAM ELEMENT NUMBER	
6. AUTHOR(S)				5d. PROJECT NUMBER	
				5e. TASK NUMBER	
				5f. WORK UNIT NUMBER	
7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES) <b>Congressional Research Service, The Library of Congress, 101 Independence Ave, SE, Washington, DC, 20540-7500</b>				8. PERFORMING ORGANIZATION REPORT NUMBER	
9. SPONSORING/MONITORING AGENCY NAME(S) AND ADDRESS(ES)				10. SPONSOR/MONITOR'S ACRONYM(S)	
				11. SPONSOR/MONITOR'S REPORT NUMBER(S)	
12. DISTRIBUTION/AVAILABILITY STATEMENT <b>Approved for public release; distribution unlimited</b>					
13. SUPPLEMENTARY NOTES					
14. ABSTRACT					
15. SUBJECT TERMS					
16. SECURITY CLASSIFICATION OF:			17. LIMITATION OF ABSTRACT <b>Same as Report (SAR)</b>	18. NUMBER OF PAGES <b>6</b>	19a. NAME OF RESPONSIBLE PERSON
a. REPORT <b>unclassified</b>	b. ABSTRACT <b>unclassified</b>	c. THIS PAGE <b>unclassified</b>			

**Figure 1. U.S. Exports and Imports of Goods & Services as a Percentage of GDP: 1960-2007 and Projections Through 2037**



Source: U.S. Census Bureau and Economist Intelligence Unit.

Note: long-term projections of the U.S. economy should be viewed with caution.

U.S. economic integration with the world has greatly changed the nature and complexity of U.S. trade flows. For example, many U.S. firms have shifted production abroad to take advantage of lower costs with some production sold locally and some exported, including to the United States. In addition, many firms in the United States import inputs (such as auto parts) to produce finished goods (such as cars). Trade in services, while much smaller than merchandise trade, is becoming an increasingly important component of U.S. trade.<sup>1</sup> Many commercial activities in the United States that impact trade are not always reflected in U.S. trade data. For example, many U.S. companies design and develop products that are manufactured overseas, such as in China. Frequently, a significant share of the value added to these products (and profits) accrue to U.S. firms and workers, while only a small part of the value added accrues to where the products are made.<sup>2</sup> Finally, over the past several years, a significant level of U.S. trade (especially imports) has shifted away from developed countries (such as Western Europe and Japan) to developing countries (especially those in Asia, such as China). From 1985 to 2007 the share of U.S. merchandise exports to developing countries rose

<sup>1</sup> From 1960 to 2007, services exports as a share of GDP rose from 1.2% to 3.6%, while services imports rose from 1.5% to 2.7% of GDP.

<sup>2</sup> In many cases, the product is simply assembled from imported parts and then exported. The value added of that assembly is often quite small. U.S. import data records only the final value of the product that is imported and does not distinguish between the value added in the country where the product is made and the value added contributed by U.S. and other foreign firms.

from 33% to 49%, while the share of U.S. merchandise imports from these countries rose from 35% to 57%.

Financial flows play a critical role in the U.S. global economic integration. In 2007, the United States was the largest cumulative source of foreign direct investment (FDI) around the world at \$2.6 trillion and was the largest cumulative destination of FDI at \$1.8 trillion.<sup>3</sup> FDI plays a critical role for many U.S. firms attempting to sell their goods and services in foreign markets. Many companies set up subsidiaries abroad in order to tailor products and services to suit each country's specific tastes or standards (or because of lower costs). These overseas subsidiaries often import machinery, parts, and other inputs from the parent company in the United States and thus help generate U.S. exports. FDI in the United States helps create employment (about 5.1 million jobs in 2005 by majority-owned nonbank U.S. affiliates of foreign companies). According to the Bureau of Economic Analysis, U.S. affiliates of foreign firms accounted for 20% of U.S. exports and 25% of U.S. imports in 2005. In addition, foreign investment has gone into U.S. securities, such as U.S. Treasury securities, which is used to finance U.S. budget deficits. This investment helps to fund the shortfall in U.S. domestic savings relative to its investment needs and enables the United States to enjoy healthier economic growth and relatively lower interest rates. As of March 2008, foreign investors owned 51.4% of privately-held U.S. debt (at \$2.4 trillion).<sup>4</sup> A major concern for many U.S. policymakers and economists is the size and growth of the U.S. trade deficit. The current account balance (the broadest measurement of trade flows because it includes merchandise trade, services trade, investment income and unilateral transfers) went from a \$2.9 billion surplus in 1991 to a \$738.6 billion deficit in 2007. The deficit reflects the high level of foreign savings the United States must obtain to fund its investment needs.

## The Debate Over the Impact of Trade

Many mainstream economists contend that free trade is a win-win situation because it enables countries to focus on producing goods they are the most efficient at (comparative advantage) and trading for those goods they are less efficient at producing. This enables countries to consume more goods than they could if they were self-sufficient. However, some observers of trade contend that this simple explanation of trade does not always apply in today's global economy where the factors of production (including capital and technology) are internationally mobile. They argue that U.S. trade with some countries, especially those with low wages but high productivity levels (such as India and China), may not always produce net benefits for the United States if such countries are able to gain a comparative advantage in more advanced goods and services over the United States.<sup>5</sup> Another argument is that, in some cases, the benefits of trade in the United States may mainly accrue to upper income groups, while mainly hurting lower

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<sup>3</sup> Estimates made by Economist Intelligence Unit.

<sup>4</sup> Although foreign investment in U.S. securities benefits the U.S. economy in the short run, many economists have raised concerns over the long-term impact and risks of high U.S. debt and U.S. over-dependence on foreign savings.

<sup>5</sup> See *Where Ricardo and Mill Rebut and Confirm Arguments of Mainstream Economists Supporting Globalization*, by Paul A Samuelson, *Journal of Economic Perspectives*, Summer 2005. Pages 135-146. Samuelson argues that outsourcing of certain jobs to China and India could lower per capita income in the United States over the long run.

income groups (through job losses and depressed wages). For example, a factory in the United States may be closed and workers laid off because it is no longer competitive. The U.S. company might relocate production to another country, such as Mexico. Profits from this venture would accrue mainly to company officials and stockholders of the company. The laid off factory workers may find new jobs, but they may not always pay as well as the previous ones. Other economists counter that raising productivity, innovation, and education and training levels are keys to ensuring U.S. global competitiveness and high paying jobs.<sup>6</sup> They further contend that the United States cannot isolate itself from the global economy, and that protectionist measures to try to restrict imports that negatively affect certain domestic industries will adversely affect other industries and have a net negative impact on the U.S. economy.<sup>7</sup> Most trade analysts on both sides of the free trade argument contend that some sort of assistance and/or retraining should be afforded to workers that are displaced by trade (although opinions differ as to what extent that assistance should be given).<sup>8</sup>

## Trade Policy and Trade Policy Tools

U.S. post-World War II trade policy under various presidential administrations has had several interrelated objectives. One has been to secure open markets for U.S. exports. A second has been to protect domestic producers from foreign unfair trade practices and from rapid surges in fairly traded imports. A third has been to control trade for foreign policy and national security reasons. A fourth objective has been to help foster global trade to promote world economic growth. In fulfilling these objectives, U.S. policymakers have employed an array of policy tools.

**Trade Negotiations and Trade Agreements.** One set of tools are multilateral and bilateral/regional negotiations and agreements. The United States has been a major player in establishing a multilateral system of rules on trade. It was a leader in nine rounds of negotiations of the General Agreement on Tariffs and Trade (GATT), including the current Doha Development Agenda (DDA) round, that have expanded the coverage of multilateral trade rules and that led to the establishment in 1995 of the World Trade Organization (WTO). However, progress in the DDA has been slow at best as WTO members have found it difficult to reach consensus on some basic issues, such as reducing tariffs and nontariff barriers on trade in agriculture, manufactured goods, and services. These difficulties have generated debate over the future role of multilateral negotiations and the WTO itself as a tool of trade policy.

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<sup>6</sup> Worker productivity is a major factor of gaining a comparative advantage. If U.S. workers are more productive than overseas workers, they can produce more at lower cost (offsetting the advantage that low wage countries might have). Generally, jobs in U.S. export sectors pay better than those industries that do not export.

<sup>7</sup> For example, if tariffs were increased on steel imports in order to provide relief to the steel industry and its workers, prices for steel in the U.S. would likely rise. U.S. users of steel, such as the auto industry, would likely pay more for steel. Cars would cost more, hurting U.S. consumers and making U.S. auto firms less competitive in the U.S. domestic market and abroad.

<sup>8</sup> The fundamental problem with free trade from a political perspective is that the benefits of trade are widely spread and felt (such as lower prices for consumers). However, the costs of free trade tend to be more concentrated and felt (such as those workers who lose their job).

U.S. trade negotiations have become increasingly dominated by bilateral and regional negotiations to establish free trade agreements (FTAs). To date the United States has FTAs in effect with 14 countries, and FTAs with three other countries pending. Some experts and other observers view the FTAs as a building block to broader, multilateral negotiations. Others consider them an unhelpful roadblock that undermines the multilateral system (because they may lead to trading blocs and trade diversion). In general, support for FTAs in the United States and elsewhere may be waning, in part due to growing uncertainty and skepticism regarding the benefits of trade liberalization among some policymakers and various segments of the population.

**Trade Remedies.** A second group of trade policy tools are trade remedies—measures applied primarily against imports to alleviate or “remedy” the price impact of unfairly traded imports and of some fairly traded imports. Trade remedies include antidumping (AD) measures and countervailing (CV) measures applied in the form of extra duties on imports that are, respectively, sold at less than fair market value or have benefitted from foreign government subsidies, as determined by the U.S. Department of Commerce (DOC), and that cause or threaten to cause material injury to the U.S. industry, as determined by the U.S. International Trade Commission (USITC). These measures are the most frequently used trade remedies.

A more powerful, yet less frequently used, trade remedy is the escape clause or safeguard measure. Safeguards, sometimes called section 201 measures, are applied in the form of higher duties or quotas, on imports that are trade fairly but enter at such rapid rates as to cause or threaten to cause serious injury to the domestic industry. They are applied to the imports of the product from all countries. As a result, safeguards have a potentially powerful impact. The cause and injury thresholds that petitioners must meet before receiving trade remedy relief are much higher than for AD and CV measures. In addition, they require presidential approval. As a result, safeguards are not as frequently applied as other trade remedies and even less so than in the past.

Section 301 and its derivatives are another set of trade remedies that are part of trade policy “toolbox” but infrequently used. Section 301 (of the Trade Act of 1974) authorizes the USTR to apply sanctions against a trading partner that uses unfair trade practices against U.S. exports. A related provision, called “Special 301” requires the USTR to identify countries that fail to protect the rights of U.S. owners of intellectual property and to apply sanctions if the trading partner does not improve IPR protection.<sup>9</sup>

Some U.S. trading partners have criticized the “aggressive” U.S. use of trade remedies, particularly AD and CV measures (which some claim are protectionist). The European Union and Japan, for example, successfully challenged the U.S. practice of “zeroing” when calculating “fair value” in AD cases. Many WTO members have also argued that trade remedy practices should be reviewed and revised as part of the Doha Development Agenda round. Congress has mandated, as part of the Trade Promotion Authority (TPA), that the President shall not enter into any trade agreement that weakens U.S. trade remedy laws.

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<sup>9</sup> If the Section 301 or Special 301 cases involve a WTO member, U.S. trade law and WTO rules require the United States to bring a trade dispute case to the WTO for resolution.

**Other Trade Policy Tools.** Besides trade agreements and trade remedies, U.S. policymakers use other tools to achieve various policy objectives. For example, the Department of Commerce, the Department of Agriculture, the U.S. Export-Import Bank and other agencies operate programs to promote U.S. exports of manufactured goods and agricultural products.

In addition, U.S. trade preference programs, including the Generalized System of Preferences (GSP), allow certain products imported from eligible developing countries to enter the United States duty free. These programs are designed to encourage economic development in those countries. Furthermore, sometimes trade is used to achieve overtly foreign policy goals. For example, the U.S. Government controls exports of some high technology to prevent it from getting into the hands of adversaries. It also restricts trade with states deemed to be detrimental to U.S. national interests, such as Burma, Cuba, and North Korea.

## **The Future of U.S. Trade Policy**

The direction of U.S. trade policy is likely to be a hotly contested issue among U.S. policymakers over the next several years. Challenges include reaching a consensus on how to lower the U.S. trade deficit (without slowing the economy), the design and funding of programs to assist displaced workers, the extent U.S. trade remedy laws should be used to respond to unfair trade practices (without becoming protectionist), policies the federal government can initiate to help the U.S. economy become more globally competitive, strategies the United States can take to induce other countries to lower their trade barriers (multilaterally in the WTO and/or bilaterally through FTAs), and the extent that trade policy should be used to promote environment (e.g., global climate change) and worker rights. Reaching a consensus on these issues within Congress, as well as between Congress and the Administration, will likely prove difficult since the stakeholders of trade are widespread and diverse (e.g., in terms of whether free trade benefits them or hurts them), and because there are differing opinions over the effects trade has on the U.S. economy, as well as different views over which trade policies are effective in promoting U.S. trade goals.

One of the biggest challenges for the next President and Congress will be whether or not TPA, which expired in July 2007, should be renewed, thus enabling the President to pursue additional bilateral, regional, and multilateral trade agreements.<sup>10</sup> Some policymakers oppose extending TPA, contending that trade liberalization has had little positive impact on the U.S. economy and has hurt some U.S. workers, while others have argued that failure to renew TPA will undermine U.S. leadership on free trade and will enable other countries (such as China) to form trade blocs that exclude the United States, thus putting U.S. exporting firms at a disadvantage.

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<sup>10</sup> TPA establishes a method by which Congress authorizes the President to negotiate and sign free trade agreements (based on objectives and goals laid out by Congress) and establishes a fast track procedure by which Congress votes on the FTA (such as no amendments, specific timetables for consideration, and limited debate time).